

**Initial Statement of Reasons for
Proposed Adoption of California Code of Regulations,
Title 18, Sections 2000, *Retailer Reimbursement Retention*, and
2001, *Additional Allowed Retailer Reimbursement Retention***

SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY,
AND ANTICIPATED BENEFITS

Current Law

Public Resources Code section 4629.5

Public Resources Code (PRC) section 4629.5, as enacted by Assembly Bill No. (AB) 1492 (Stats. 2012, ch. 289), imposes, on and after January 1, 2013, a one-percent assessment on purchasers of lumber products and engineered wood products (Lumber Products Assessment) to be collected by retailers at the time of sale. As enacted by AB 1492, PRC section 4629.5, subdivision (a)(3) authorizes the State Board of Equalization (Board) to adopt regulations to determine the amount retailers may retain from the assessments they collect as reimbursement for certain compliance costs. Specifically, PRC section 4629.5, subdivision (a)(3), in relevant part, provides:

The retailer shall collect the assessment from the person [i.e., purchaser] at the time of sale, and may retain an amount equal to the amount of reimbursement, as determined by the State Board of Equalization pursuant to regulations, for any costs associated with the collection of the assessment, to be taken on the first return or next consecutive returns until the entire reimbursement amount is retained.

Notably, PRC section 4629.5 and the legislative analyses of AB 1492 do not expressly indicate how the Board is to determine the amount of reimbursement that retailers may retain. However, the statute does appear to provide that retailers may only retain the Board-prescribed amount of reimbursement one time, on the retailers' first returns or next consecutive returns filed immediately after the retailers are required to begin collecting the Lumber Products Assessment on January 1, 2013. And, the statute does not authorize retailers to retain additional amounts thereafter.

As to legislative history, both the relevant Senate and Assembly floor analyses refer to retailers being reimbursed for "costs to set up collection systems." (See p. 2 of the September 1, 2012, Assembly Floor Analysis of AB 1492 and p. 2 of the August 29, 2012, Senate Floor Analysis of AB 1492.) Thus, both the plain language of PRC section 4629.5, subdivision (a)(3) and the available information regarding legislative intent support an interpretation that subdivision (a)(3) provides for affected retailers to retain a one-time amount, as specifically determined by the Board, for reimbursement of costs to

set up collection systems prior to the commencement of their collection duties on January 1, 2013. Neither the plain language of PRC section 4629.5, subdivision (a)(3) nor the available legislative history persuasively support an interpretation that would allow for the retention of amounts in excess of the Board-specified reimbursement amount to compensate retailers for ongoing collection costs.

Emergency Regulation 2000

In addition, PRC section 4629.5, subdivision (a)(3), as added by AB 1492, authorizes the Board to “adopt emergency regulations,” pursuant to Government Code section 11346.1, to prescribe the amount retailers may retain from the Lumber Products Assessments they collect, and provides that the adoption of any such regulations “shall be deemed to be an emergency and necessary for the immediate preservation of the public peace, health, and safety, and general welfare.” Therefore, on October 23, 2012, the Board voted to:

- Added new chapter 4.1 to division 2 of title 18 of the California Code of Regulations so that any regulations the Board is required to adopt to implement, interpret, and make specific the Lumber Products Assessment imposed by PRC section 4629.5 can be codified in the new chapter; and
- Adopt California Code of Regulations, title 18, section (Regulation) 2000, *Retailer Reimbursement Retention*, which is codified in new chapter 4.1, as an emergency regulation, in order to determine the “amount of reimbursement” a retailer may retain pursuant to PRC section 4629.5, subdivision (a)(3), before retailers started collecting the new assessment on January 1, 2013.

Emergency Regulation 2000 provides that retailers as of January 1, 2013, may retain collected assessment amounts of up to \$250 per location as reimbursement for one-time, startup costs associated with the collection of the assessment (i.e., the costs to set up collection systems). Specifically, Regulation 2000 provides:

Public Resources Code section 4629.5, as added by Statutes 2012, chapter 289, requires the Board of Equalization to adopt a regulation to determine the amount of reimbursement a retailer may retain for costs associated with the collection of the Lumber Products Assessment imposed by Public Resources Code section 4629.5.

A retailer required to collect the Lumber Products Assessment may retain no more than \$250 per location as reimbursement for startup costs associated with the collection of the assessment. Such reimbursement is to be taken on the retailer’s first return on which the Lumber Products Assessment is reported or, if the amount of the collected assessment is less than the allowed reimbursement, on the retailer’s next consecutive returns until the allowed reimbursement amount is retained.

“Location” means and is limited to a business location registered under the retailer’s seller’s permit as of January 1, 2013, where sales of products subject to the assessment are made.

The \$250 retention amount in emergency Regulation 2000 is based on the Board’s understanding of the amount of retailer reimbursement discussed when AB 1492 was drafted. Staff also estimated the \$250 retention amount in emergency Regulation 2000 using U.S. Census Bureau data and a 2006 PricewaterhouseCoopers report on gross retail sales tax compliance costs for programming and servicing cash registers for sales tax rate and bases changes (PricewaterhouseCoopers report). And, emergency Regulation 2000 recognizes that an affected retailer’s start-up costs will be affected by the number of retail locations the retailer must get ready to collect the new assessment on January 1, 2013.

An emergency regulation adopted pursuant to Government Code section 11346.1 is effective for a 180-day period. The Office of Administrative Law (OAL) may approve two readoptions of the same emergency regulation, under specified circumstances, each for an effective period of 90 days. However, an emergency regulation will automatically be repealed and deleted from the California Code of Regulations, unless the regulation is readopted through the regular rulemaking process before the emergency regulation ceases to be effective. (Gov. Code, § 11346.1, subds. (e), (g), and (h).)

Emergency Regulation 2000 became effective on January 1, 2013. The Board subsequently readopted emergency Regulation 2000 in accordance with Government Code section 11346.1, subdivision (h). OAL approved the readoption on June 25, 2013, and indicated that readopted emergency Regulation 2000 will not expire until September 24, 2013. Therefore, OAL still has discretion to approve one more readoption of emergency Regulation 2000 before that time, which may extended the effective period of the regulation by an additional 90 days.

Specific Purpose of, Problem Intended to be Addressed by, Necessity for, and Anticipated Benefits from the Proposed Regulations

Business Taxes Committee Process

The California Forestry Association supported the initial adoption of emergency Regulation 2000 and the \$250 reimbursement amount established by the regulation. However, the Board did not immediately propose to adopt emergency Regulation 2000 through the regular rulemaking process because other interested parties, including the California Retailers’ Association and the West Coast Lumber & Building Material Association (West Cost), argued that affected retailers should receive more reimbursement, including reimbursement on an ongoing basis. Therefore, on October 23, 2012, the Board also unanimously voted to begin a Business Taxes Committee (BTC) process to meet with interested parties and discuss the adoption of a regulation, through the regular rulemaking process, to permanently specify the amount of reimbursement a retailer may retain for costs associated with the collection of the Lumber Products Assessment imposed by PRC section 4629.5 beginning January 1, 2013. However,

Board staff was not able to reach a consensus with all of the interested parties regarding the substantive provisions of the permanent regulation during the BTC process. Therefore, Board staff summarized the BTC process and the remaining areas of disagreement in Formal Issue Paper 13-005, and distributed it to the interested parties and Board Members on May 31, 2013.

Start-up Costs and Ongoing Costs

Formal Issue Paper 13-005 explains that some interested parties read PRC section 4629.5, subdivision (a)(3), as providing for reimbursement of “any costs” associated with the collection of the Lumber Products Assessment, including ongoing costs. However, as previously discussed, Board staff believes that PRC section 4629.5, subdivision (a)(3) authorizes the Board to determine and prescribe a specific one-time amount of reimbursement for start-up costs to implement the Lumber Products Assessment on January 1, 2013, that may be retained by all affected retailers, regardless of their actual costs; and staff does not believe that the statute allows retailers to retain a percentage of the assessments they collect or retain unique amounts of reimbursement for their actual start-up or ongoing costs. This is primarily because:

- PRC section 4629.5 expressly provides that retailers may only retain “an amount” determined by the Board and does not authorize retailers to calculate and retain other amounts;
- PRC section 4629.5 requires a retailer to retain the Board prescribed amount of reimbursement from the assessments reported on its “first return or next consecutive returns until the entire reimbursement amount is retained”; and
- PRC section 4629.5 does not expressly provide for the ongoing retention of a percentage of collected assessments, as do the California Tire Fee Law and Covered Electronic Waste Recycling Fee Law, which both expressly authorize retail sellers to retain 1.5 percent (PRC § 42885) and 3 percent (PRC § 42464), respectively, of the fees they collect as ongoing reimbursement of collection costs.

The formal issue paper also explains that staff’s understanding of PRC section 4629.5, subdivision (a)(3), is consistent with the Senate and Assembly floor analyses of AB 1492, which refer to retailers being reimbursed for “...costs to set up collection systems,” not ongoing costs of collection. The formal issue paper further explains that the interested parties that supported AB 1492, including the California Forestry Association, California Native Plant Society, Forests Forever, Pacific Forest Trust, Sierra Club, and the Center for Biological Diversity, have confirmed that staff’s understanding of PRC section 4629.5, subdivision (a)(3) is consistent with the intent of AB 1492. In addition, the formal issue paper indicates that California Assemblymembers Bob Blumenfield, Wesley Chesbro, Richard Gordon, Richard Bloom, and Roger Dickinson have recommended to the Board that reimbursement be limited to startup costs.

Amount of Reimbursement for Start-up Costs

In addition, Formal Issue Paper 13-005 explains that Board staff and some interested parties continue to disagree about the “amount” that affected retailers should be permitted to retain as reimbursement for start-up costs. These interested parties believe that the reimbursement amount in emergency Regulation 2000 is too low and that the amount should be increased to compensate most retailers for their actual start-up costs. For example, the formal issue paper explains that Caseywood estimated that it cost \$7,000 to implement computer system, internal process, and accounting changes necessary to comply with the new law. Other retailers advised staff that their current accounting systems could not be updated to calculate the new assessment, and that they were forced to update both software and hardware, at an estimated cost of \$45,000, in order to implement the assessment. Also, West Coast surveyed its members and informed staff that that the members’ average cost to implement the assessment was \$5,480 per location.

The formal issue paper explains that, to get a better idea of retailers’ average costs to update their software for the Lumber Products Assessment, staff contacted three software companies that provide software packages for the retail lumber industry. One company indicated that it included the update to collect the assessment in its annual software update and did not charge an additional amount to its existing customers, and the other software providers advised staff that for current customers they generally charged \$250 per location to update their software to collect the assessment. The latter providers also explained that they priced their updates to match the amount provided in the Board’s emergency regulation as a courtesy to existing customers and as a selling point to attract new customers. The software providers also explained that their charges (if any) did not include the hours spent reviewing inventory and coding SKU’s (stock keeping units) for products subject to the assessment. These tasks were typically completed by a retailer’s employees with the expense incurred directly by the retailer. Further, staff learned that retailers who use custom or proprietary accounting software were not able to take advantage of pricing discounts from package software providers and generally paid hourly rates for software technicians to update their systems. Furthermore, staff found that one company estimated that for a new retail account, they would charge about \$30,000 plus a monthly fee to set up a whole new accounting system that performed various functions, including collecting the Lumber Products Assessment.

The formal issue paper also explains that, to get a better idea of retailers’ average costs to update their software for the assessment, staff continued to review the available cost data, including the PricewaterhouseCoopers Report, referred to above, and found another reasonable alternative method that could be used to estimate affected retailers’ average start-up costs. First, staff found that “the purpose of AB 1492 was, among other things, to ensure continued sustainable funding for California’s forest program to protect the state’s forest resources and to replace the current piecemeal funding structure with a single funding source” and that the amount of allowed retention directly affects the revenue the fund receives. Second, in Board staff’s September 11, 2012, Legislative Enrolled Bill Analysis of AB 1492, staff estimated that the new one-percent Lumber Products Assessment would generate annual revenue of \$35 million from approximately \$3.5 billion of sales subject to the assessment. Third, during the BTC process, staff estimated, using U.S. Census Bureau data, that there were close to 10,000 retail locations

that were required to begin collecting the new assessment on January 1, 2013, and that each location would collect an annual average of \$3,500 in assessments on average annual sales of \$350,000 subject to the assessment.

Fourth, during the BTC process, staff also analyzed the PricewaterhouseCoopers Report in more detail, and found that the \$250 amount in emergency Regulation 2000 accounted for costs to program and service cash registers (and other point-of-sale systems), but did not account for the following seven other categories of compliance costs, included in the study: (1) training personnel; (2) documenting exempt sales; (3) customer service relating to assessment issues other than documenting exempt sales; (4) assessment-related software acquisition and license fees; (5) return preparation, making remittances, refund and credit claims, and research relating to the assessment; (6) dealing with audits and appeals; and (7) other costs (such as costs related to data storage, registration, etc.). Further, staff found that the PricewaterhouseCoopers Report shows an average gross compliance cost of 0.21 percent of taxable sales for the Building and Garden Supplies industry. Furthermore, staff recognized that the percentage was derived from looking at some costs that were not properly classified as start-up costs, such as costs to deal with audits and appeals, but that the percentage also failed to account for some costs that were properly classified as start-up costs, such as costs to identify and code products subject to the assessment. Therefore, staff concluded that it would be reasonable to use the percentage to calculate start-up costs.

As a result, in the formal issue paper, staff calculated that the average amount of start-up costs to implement the Lumber Products Assessment on January 1, 2013, was approximately \$735 per retail location by multiplying the average amount of annual sales subject to the assessment that staff estimated would be made by each retail location (\$350,000) by 0.21 percent. Staff also proposed that affected retailers be permitted to retain an additional \$485 (\$735 - \$250) from the assessments they collect, for start-up costs, beginning January 1, 2014.

Alternative Recommendations

Based upon the above discussion, Formal Issue Paper 13-005 contained the following three recommendations:

1. Staff's recommendation that the Board propose to adopt emergency Regulation 2000, through the regular rulemaking process, without making any changes, and that the Board also propose to adopt new Regulation 2001, *Additional Allowed Retailer Reimbursement Retention*, through the regular rulemaking process, to provide that "[b]eginning January 1, 2014, a retailer required to collect the Lumber Products Assessment may retain \$485 per location, in addition to the \$250 allowed by Regulation 2000, as [additional] reimbursement for startup costs associated with the collection of the assessment";
2. An alternative recommendation that the Board only propose to adopt emergency Regulation 2000, through the regular rulemaking process, without making any changes, which is supported by the California Forestry Association, California

Native Plant Society, Forests Forever, Pacific Forest Trust, Sierra Club, and the Center for Biological Diversity, and was recommended by California Assemblymembers Bob Blumenfield, Wesley Chesbro, Richard Gordon, Richard Bloom, and Roger Dickinson; and

3. Another alternative recommendation that the Board adopt a regulation, through the regular rulemaking process, that permits retailers to initially retain \$5,500 per retail lumber location and annually retain an additional \$1,500 per location on an ongoing basis, based upon a recommendation from West Coast.

BTC Meeting

The Board considered Formal Issue Paper 13-005 during its BTC meeting on June 11, 2013. The Board agreed that the purpose of AB 1492 was to ensure continued sustainable funding for California's forest program to protect the state's forest resources and that it was reasonable to consider how the amount of reimbursement established by the Board affects the revenue available for such purpose. The Board agreed with staff that PRC section 4629.5, subdivision (a)(3) authorizes the Board to determine and prescribe a specific one-time amount of reimbursement for start-up costs to implement the Lumber Products Assessment on January 1, 2013, that may be retained by all affected retailers, regardless of their actual costs. The Board also tentatively agreed with staff's revised calculation of the average amount of start-up costs to implement the Lumber Products Assessment on January 1, 2013, of approximately \$735 per retail location. Therefore, the Board voted to propose to adopt emergency Regulation 2000, through the regular rulemaking process, without making any changes, and also to propose to adopt new Regulation 2001, through the regular rulemaking process, to provide an additional \$485 per location, in addition to the \$250 allowed by Regulation 2000, as reimbursement for startup costs associated with the collection of the Lumber Products Assessment.

However, staff's revised calculation of the average start-up costs per retail location relied upon:

- Staff's estimate that the new one-percent Lumber Products Assessment would generate annual revenue of \$35 million from approximately \$3.5 billion of sales;
- Staff's estimate that there were close to 10,000 retail locations that were required to begin collecting the new assessment on January 1, 2013;
- The conclusion, drawn from those estimates, that each retail location would make average annual sales of \$350,000, subject to the assessment; and
- Staff opinion that it was reasonable to use the average gross compliance cost of 0.21 percent of taxable sales for the Building and Garden Supplies industry from the PricewaterhouseCoopers Report to estimate the average start-up costs for the Lumber Products Assessment.

As a result, additional information may change staff's estimates, conclusions, and opinions, help staff identify other, more reliable methods to calculate the average start-up costs per retail location, or both. Therefore, at the conclusion of the BTC meeting, the Board also directed staff to continue to monitor the implementation of the Lumber

Products Assessment and review the returns filed for the first and second quarters of 2013 to try to obtain additional information to help verify the number of retail locations that were required to begin collecting the new assessment on January 1, 2013, and the amount of revenue they are actually collecting. And, the Board indicated that, depending upon the additional information obtained, including information regarding the effectiveness of AB 1492 as a source of funding, and staff's recommendation at the public hearing, the Board may decide to adopt proposed Regulation 2000 without making any changes and not adopt proposed Regulation 2001, the Board may decide to adopt both proposed regulations without making any changes, or the Board may decide to adopt both regulations and change the total amount of reimbursement provided to affected retailers.

PRC section 4629.5 creates a problem, within the meaning of Government Code section 11346.2, because it permits affected retailers to retain a Board-prescribed amount of the Lumber Product Assessments they collect as reimbursement for collection costs, but section 4629.5 and the legislative analyses of AB 1492 do not expressly indicate how the Board is to determine the amount of reimbursement. The Board has determined that the adoption of proposed Regulations 2000 and 2001 is reasonably necessary for the specific purpose of specifying the amount of reimbursement that affected retailers may retain pursuant to PRC section 4629.5, and addressing this problem. The regulations are anticipated to provide the following benefits:

- Provide certainty as to the amount of reimbursement retailers may retain pursuant to PRC section 4629.5;
- Permit retailers to retain the amount of reimbursement determined by the Board without requiring retailers to keep additional records or substantiate their individual costs; and
- Preserve the public peace, health, safety, and general welfare, as provided in PRC section 4629.5, subdivision (a)(3).

The adoption of proposed Regulations 2000 and 2001 is not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to proposed Regulation 2000 or 2001.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 13-005, the exhibits to the formal issue paper, and the comments made during the Board's discussion of the formal issue paper during its June 11, 2013, BTC meeting in deciding to propose the adoption of Regulations 2000 and 2001 described above.

ALTERNATIVES CONSIDERED

As previously discussed, the Board considered two alternatives to the proposed regulatory action. The first alternative was for the Board to only propose to adopt emergency Regulation 2000 through the regular rulemaking process. The second alternative was for the Board to adopt a regulation, through the regular rulemaking

process, that permits retailers to initially retain \$5,500 per retail lumber location and annually retain an additional \$1,500 per location on an ongoing basis.

The Board has not decided to pursue the first or second alternatives at this time. However, the Board has decided to propose to adopt emergency Regulation 2000 through the rulemaking process, and the Board has indicated that it may eventually decide to adopt emergency Regulation 2000 without adopting proposed Regulation 2001. Therefore, the Board is still considering and has not rejected the first alternative.

In addition, the Board has indicated that it may decide to increase the amount of reimbursement for start-up costs provided to affected retailers by the proposed regulations prior to their adoption. Therefore, the Board is still considering and has not completely rejected the part of the second alternative pertaining to the amount of reimbursement for start-up costs, although it does not appear likely that new information will support increasing the amount of reimbursement provided for start-up costs from \$735 to \$5,500 per retail location.

The Board has rejected the part of the second alternative regarding the proposed adoption of a regulation providing retailers with reimbursement of ongoing costs because the Board determined that providing reimbursement for ongoing costs is inconsistent with PRC section 4629.5.

No other alternatives have been identified and brought to the Board's attention, and no reasonable alternative has been identified and brought to the Board's attention that would be less burdensome and equally effective in achieving the purposes of the proposed regulatory action in a manner that ensures full compliance with PRC section 4629.5 and achieves the purpose of AB 1492.

**INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2,
SUBDIVISION (b)(6) AND ECONOMIC IMPACT ANALYSIS REQUIRED BY
GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)**

PRC section 4629.5 imposes the Lumber Products Assessment and any start-up or ongoing costs that retailers incur in compliance with PRC section 4629.5 are imposed by that statute and not a regulatory action. PRC section 4629.5 also provides that affected retailers may retain a Board-prescribed amount, as reimbursement for start-up costs. However, the statute is silent as to how the Board should determine the amount. And, there is no single amount that will compensate all affected retailers for their actual start-up costs, but not more. Therefore, the Board is proposing to adopt Regulations 2000 and 2001 to implement, interpret and make specific PRC section 4629.5 by prescribing \$735 per retail location as a reasonable, average amount of reimbursement for start-up costs based upon information indicating that some retailers will incur more and some retailers will incur less actual start-up costs, and information indicating that providing more reimbursement may impair the effectiveness of the Lumber Products Assessment as a source of revenue.

Further, the proposed regulations will allow affected retailers to retain the Board-prescribed amount of reimbursement without having to incur additional, non-reimbursable costs to substantiate their actual start-up costs. Therefore, there is no basis to conclude that affected retailers will incur any costs in reasonable compliance with proposed Regulations 2000 and 2001.

Furthermore, the adoption of proposed Regulations 2000 and 2001 is anticipated to provide the following benefits:

- Provide certainty as to the amount of reimbursement retailers may retain pursuant to PRC section 4629.5;
- Permit retailers to retain the amount of reimbursement determined by the Board without requiring retailers to keep additional records or substantiate their individual costs; and
- Preserve the public peace, health, safety, and general welfare, as provided in PRC section 4629.5, subdivision (a)(3).

Therefore, the Board understands that the enactment of PRC section 4629.5 may have an economic impact on business. However, the Board has determined that the adoption of proposed Regulations 2000 and 2001 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

In addition, proposed Regulations 2000 and 2001 will not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed regulations will not affect the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of proposed Regulations 2000 and 2001 will not have a significant adverse economic impact on business.

The proposed regulation may affect small business.